

Using a 'systems' perspective to explain the limits of 'new' multinational enterprises: the role of 'members only' location advantages

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Using a 'Systems' Perspective to Explain the Limits of 'New' Multinational Enterprises: the role of 'members-only' location advantages

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**Using a ‘Systems’ Perspective to Explain the Limits of ‘New’ Multinational Enterprises:
the role of ‘members-only’ location advantages**

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23 April 2013

Abstract: I take as a starting point that the location-specific assets of the home country determine to a significant degree firm-specific assets of its firms and MNEs. This strong bond persists because of the interdependence between actors within a system, which has a growing cross-border aspect due to globalization. I highlight the importance of institutions, not as a black box of rules, but as an invisible mesh that envelope, shape and constrain the actions of actors in a given system, and these actors are themselves – collectively and occasionally individually – responsible for the nature of institutions.

I highlight that location advantages are not always freely available to all actors in a given location. There are important location advantages that are ‘members-only’ for which access is restricted to incumbents, and do not have a public good nature implied in the IB literature. This lies at the heart of the inertia of firms, and the difficulties of successfully leveraging location-bound assets in other countries, as well as the challenges of ‘leaving home’, since they may forfeit domestic ‘membership’ to do so. Home country L assets play a large part in defining EMNE FSAs, and where governments are unable to upgrade these (due to government failure or regulatory capture) it weakens the building block upon which sustainable outward FDI is possible.

Keywords: collocation, innovation systems, emerging countries, MNEs, institutions, globalization, location advantages

JEL: F23, F68, O32.

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INTRODUCTION

In this paper I analyse the role of locations in shaping the mobility (or lack thereof) of multinational companies (MNCs) (and in particular emerging country multinational companies (EMNCs)) in a globalizing world. I am of the opinion that emerging country MNCs are not vastly different from ‘adolescent’ MNCs from other home countries, in terms of the principles by which they internationalize (Narula, 2010, 2012). I use the term ‘adolescent’ in the sense proposed by Ramamurti (2008) to describe an MNC that is not ‘mature’ in the extent to which it has developed firm-specific assets to manage and coordinate complex cross-border transactions. I am also of the opinion – despite the impression in some of the academic literature, as well as the popular press – that EMNCs as a phenomenon will not continue to demonstrate the consistently rapid growth rates that have fascinated commentators on globalization. As such, my discussion here is relevant to all adolescent MNCs, of which EMNCs are a subset. I will argue that there are two seemingly apposite explanations for their limited growth in the future. First, given that EMNC activities abroad are a function of their home country activities, the challenges of their home countries to fully adapt to the challenges of global interdependencies will impede growth. Second, the ability of EMNCs to fully exploit the opportunities available to them in developed country host locations is also affected by the weaknesses of their home country milieu, and the challenges of integrating into their host countries.

As I intend to explain, firms are not islands of economic activity, but are bound to locations because they are embedded (or insufficiently embedded, as the case may be), and this determines their success or failure, perhaps just as much as does their ownership of firm-specific assets. These firm-specific advantages (FSAs) are themselves a function of these relationships.

To step back just a bit: globalization as used here is taken to mean the increasing interdependence of firms, countries, and markets for goods, services, and capital (Narula, 2003). Generally speaking, globalization has not made firms (of which a subset are MNCs) necessarily more mobile. This reflects misunderstandings about the nature of globalization and how it affects locations, especially the nation-state. The nation-state still matters as a unit of analysis. Borders may have become fuzzy, but sovereignty still matters because governments still matter. As I will highlight here, emerging countries (like all countries) are complex organisms, of which firms are a relatively small subset of actors. The way these various actors relate to each other is also an important factor in shaping their location advantages. It is for this reason I wish to emphasize the importance of taking a systems view of an economy.

Globalization means that the milieu within which economic activity takes place has been considerably altered, such that the way in which most economic actors organize themselves, as well as their interactions with other actors, has fundamentally changed. This means that institutions and actors that are geographically distant from the location under analysis play a non-negligible role in influencing the dynamics within the system.

It is worth emphasizing that I take as a starting point that the location-specific assets of the home country determine to a significant degree the firm-specific assets of its firms and

MNCs. It is important to understand why this strong bond continues to persist despite globalization, and why this is likely to remain so. This requires an understanding of the interdependence between actors within a system, and the role of institutions. I seek in this chapter to highlight the importance of institutions, but not in the somewhat generic way that they are utilized in the IB literature, which tends to examine institutions as a black box of efficient and inefficient rules within countries that exogenously impinge on the actions of MNCs. Institutions matter because they are an invisible mesh that envelop, shape, and constrain the actions of actors in a given milieu, and these actors are themselves – sometimes collectively and occasionally individually – responsible for the nature of institutions. Economic actors – by their very presence in a specific locale – affect institutions, both singly and collectively.

I intend to use this framework to help highlight that location advantages are not always freely available to all actors in a given location. Especially for more knowledge-intensive activities, there are important location advantages that are ‘members-only’ for which access is restricted to incumbents, and that do not have a public-good nature implied in some of the IB literature (Narula and Santangelo 2012). This lies at the heart of the inertia of firms, and the difficulties of successfully leveraging location-bound assets in other countries, as well as the challenges of ‘leaving home’, since they may forfeit domestic ‘membership’ to do so. MNEs do not easily embed in a new location, and this requires considerable firm-specific assets associated with recombinant advantages, which are hard to acquire except through experience. There are also a specific set of issues relating to EMNEs, and these relate to the weakness of their home country L advantages. Home country L assets play a large part in defining EMNEs FSAs, and where governments are unable to upgrade these (*inter alia* due to government failure or regulatory capture) it weakens the building block upon which sustainable outward FDI is possible.

THE MNC AS PART OF A ‘SYSTEM’ AND THE ROLE OF GLOBALIZATION

Economic globalization is essentially about structural changes in the world economy that have resulted in: (1) An increasing number and range of both national (and collocated) and non-national (and not-collocated) actors that impinge on the activity of any given actor; and (2) An alteration in the nature and variety (both in terms of intensity and extensiveness) of the interactions due to this increased number of actors.

Globalization means that the milieu within which economic activity takes place has been considerably altered, such that both the way in which most economic actors organize themselves and the way in which they interact with other actors has fundamentally changed. This means that institutions and actors that are physically ‘elsewhere’ from the location under analysis now play a non-negligible role in influencing the dynamics within the system.

It is important to acknowledge that globalization is a process. This growing interdependency between economic actors has been on-going for a long period of time, and different locations have achieved different levels of cross-border interdependencies. Of course, there is huge variation between and among countries, and this is especially so in the case of developing countries. My main concern in this instance is to highlight that developing countries have been thrust into an accelerated and much more compressed version of what has been happening more gradually and over a longer period of time in most developed

economies. In order to appreciate the challenges and opportunities that this compressed process represents, we need to see the economy as a 'system'.

I have used the term 'economic actors' deliberately, to include here not only MNCs, but all formally and systematically organized entities, each functioning (however imperfectly) as a clearly delineated single organization for the generation of a specific set of outcomes or goals defined by their stakeholders. 'Stakeholders' and 'goals' differ among these actors. For firms, the goal tends to be optimising profits, and the stakeholders are its shareholders. The motives of governmental and non-governmental organizations (which I will refer to here as 'non-firms') are not profit-based, so the improved welfare of a certain section of society is often a primary outcome or goal. By referring to economic actors I am able therefore to account for very small actors (such as individual entrepreneurs), or very large ones (such as a nation-state, which itself consists of individuals). They are – at least all that wish to be successful – engaged in generating outputs by means of marshalling the resources of their organization in the most efficient way possible. I use the term 'efficient' to mean the basic principle of outputs generated per unit of input. The logic of how each economic actor interacts with others is based on similar principles, regardless of its size or the nature of its intended goal.

Interactions between the various actors are shaped by institutions, and by institutions I mean 'routines, habits, and procedures' that regulate the interaction between economic actors (Edquist & Johnson, 1997). These may be codified, formally acknowledged and established through laws, regulations, and other codified protocols, or may be more informal in nature, and in that case often uncoded.

There is a strong neo-classical economics bias to the IB and management literature that implies that firms are free agents, and because knowledge is in principle available freely to all, entrepreneurs are able to determine their outputs based largely on firm-specific resources and profit maximising motives. This is not entirely true, however, because firms are also constrained by other actors within their milieu, which we refer to here as a 'system'. Firms are embedded through historical, social, political, and economic ties to other actors within this system. Governments may restrict entry into certain sectors, for instance. Complementary assets from support and related industries are also essential. To set up an airline requires the availability of jet fuel, maintenance service providers, caterers, airports, airport facilities, etc. It also requires a government policy that permits private firms to engage in this industry, and regulations (and agencies to implement them) on safety, pollution, air traffic control systems, etc.

A variety of academic perspectives incorporate a systems approach: for instance, the innovation systems concept (e.g., Lundvall, 1992; Edquist, 1997; Narula, 2003) and network theory (Gulati 1998). A number of these approaches have delineated their analysis by taking the nation-state as the boundary of their analysis. It is also possible to think of a national system as imperfectly analogous to Porter's (1990) diamond of national competitive advantage.

As with Porter's diamond, however, few economies are stand-alone, and most have a distinctive international aspect to them (Dunning, 1992; Rugman & D'Cruz, 1993). However, depending upon the degree to which economies are internationalized, it may be unreasonable to consider highly internationalized economies purely from a national perspective, as

emphasized by Rugman and associates in the double diamond approach (Rugman & D'Cruz, 1993; Moon et al., 1995).

Likewise, similar comments have been made about the national system of innovation approach. While such an approach made considerable sense in a pre-globalization era, by the 21st century few countries have truly 'national' systems. By and large, most economic actors within a system have a growing interdependence on actors outside their national boundaries (Narula, 2003). Of course, the degree to which non-national actors affect domestic activity varies considerably.

Pre-Globalization Era and the Internationalization of Emerging Market Firms

It is safe to say that prior to the 1990s – which I will refer to as the *pre-globalization era* – most developing economies¹ were closed systems, with a policy orientation best described as import-substituting and inward-looking, with only sporadic external linkages (Figure 1). Most developed economies and a handful of emerging economies (notably the newly industrialized Asian countries: Singapore, Hong Kong, Taiwan, and Korea) had an outward-looking, export-oriented economic system with cross-border linkages². In the pre-globalization era, however, these non-national links were typically shallow, either through trade or occasionally FDI; inward FDI accounted for less (usually much less) than 5 per cent of value adding of these economies. As such, even these economies could usefully be modelled as primarily 'national' systems (Narula & Dunning, 2010).

Figure 1 about here

Figure 1 gives a general idea of the primary influences on economic actors in pre-liberalized, import-substituting economies circa 1980s. As Figure 1 illustrates, domestic firms in developing countries tended to have limited and sporadic international links, being largely dependent upon domestic suppliers and customers. Limited linkages to foreign companies existed through arms-length agreements such as technology licensing, turnkey contracts, and capital equipment imports. Likewise, MNC affiliates in the local economy were 'detached' from their parent MNCs, as most MNCs tended to organize their emerging economy activity on a multi-domestic basis, concentrating on meeting local markets. The domestic non-firm sector was the primary source of employees and scientific and technological infrastructural support, and its link to international sectors was also limited and indirect.

The limited links were not just a result of the policy frameworks and the political economy of these developing countries, but were to some extent structural to the world economy at large. The impact of major technological changes such as in information and communication technologies (ICTs) and improvements in transportation have allowed firms

¹ It is worth noting that most of the communist economies of Central and Eastern Europe (referred to here as the 'transition economies') were even more closed. However, through the process of economic transition over the last two decades, most of these economies may now be thought of as developing economies, with few artefacts of the non-capitalist era remaining. Of course, significant exceptions exist, but even so, growing cross-border trade and investment has meant that few have purely national systems (Narula & Jormanainen, 2008).

² Even amongst these four Asian NICS there was considerable variation between countries (Lall, 1992, 1996).

to engage more directly in cross-border activities across the board, and also to coordinate and integrate these activities since the 1980s (Cuervo-Cazurra, 2012).

Emerging economy government policies played a primary role in the activities of the domestic system, creating a variety of incentives and restrictions to promote their industrial and development policies. Policy was largely shaped by domestic priorities, with a relatively small influence due to various supranational agreements such as GATT, and bilateral treaties.

Even in the developed countries, it was still the case in the 1960s and 1970s that economies were largely 'national'. Nonetheless, assisted by *de facto* and *de jure* economic integration, coupled with social and political ties that have evolved over a long period, developed countries have traditionally had a greater degree of cross-border interdependence (albeit between geographically proximate countries within the same region). With globalization, this interdependence has increased even further. Figure 2 gives a sense of a 'typical' system for an EU country post-1992 (i.e., after the single market was established). Similar but less intense linkages will be seen between Canada and the US.

Figure 2 about here

Figures 1 and 2 are obviously stylized expressions of two different types of economies, but together they help to contrast and highlight the degree to which developing countries and advanced economies had non-national influences within their economic system. They help to illustrate the 'gap' between the two systems and the degree to which domestic firms were dependent upon external actors.

The Globalization Era and Internationalization of Emerging Market Firms

The *globalization era* has seen a fundamental change in the economic structure of emerging economies, from a closed system towards a more outward-oriented and internationally interdependent system. This 'structural adjustment' implied that developing economies began to shift their close systems (Figure 1) towards a more intertwined 'global' system as depicted in Figure 2. Specifically, this occurred through a concatenated series of changes. This is a process that is idiosyncratic to each individual economy and is still ongoing, but broadly speaking all developing economies are experiencing a similar set of profound changes.

First, the competitive pressures on domestic firms increased in almost every country, due to inward FDI. Furthermore, there have been increasing numbers of domestic firms that are formally or informally linked to networks of firms abroad, in addition to once purely domestic firms that have become MNCs. Customers are not limited to domestic suppliers, and there is keen pressure on prices and quality.

Second, the economic structure of the domestic market has also changed. State-owned enterprises (SOEs) and powerful large private enterprises (which have tended also to enjoy privileged status within the domestic milieu, as national champions) have been able to expand abroad financed in part by monopoly profits from closed, protected markets generated over the pre-globalization era. WIPRO, a large Indian software company, for instance, began life as India's largest manufacturer of vegetable and cooking oils, expanding into ICTs only after

liberalization. At the same time, the liberalization of the domestic economy has acted as a catalyst for a new generation of domestic actors, which are typically small but able to exploit the new opportunities that derive from more open markets.

Third, new sources of inputs – either in the form of services and support industries, or in the form of suppliers within the same value chain – from abroad have also become available. For example, foreign-owned banks and other financial service providers have increased the competition in a sector that typically in most developing countries has been dominated by a few large, inefficient domestic (state-owned) players.

Fourth, firms are affected by extra-national regulation. As their customer and supplier bases are increasingly located abroad, they must comply with and react to government policies and regulations in multiple locations.

Figure 3 illustrates how internationalization in the scope of the system of emerging economies has evolved over the last 20 years. Some domestic firms have established foreign activities, and the domestic system is now indirectly influenced by knowledge sources through the activities of their foreign affiliates. MNC affiliates have become more integrated with their parent firms, as MNCs have sought to reassert control and exploit economies of scale and scope from a wider MNC network. At the same time, firms – of all nationalities – have become dependent upon a broader geographical clientele as well as more diverse networks of suppliers, both domestic and foreign.

Figure 3 about here

Firms in the domestic milieu are no longer as reliant upon the domestic non-firm sector. Either indirectly via links through their foreign-located affiliates, or directly, they are directly engaged with foreign-located universities, research institutes, and non-governmental organizations.

Indeed, many of the advanced economy universities and research institutes have also internationalized their operations, setting up campuses and facilities in developing countries. Fraunhofer, a German private (but state-supported) research organization, has actively begun to establish research facilities in South America and Asia. Most universities – regardless of nationality – have active research links with other universities in a broad swath of countries, which include staff exchanges and joint research laboratories.

Emerging economy governments now – in this new global milieu – have limited policy space due to World Trade Organization (WTO) agreements which restrict domestic policies on subsidies, incentives, national champions, tariffs, barriers to entry, and preferential treatment. In addition, domestic firms are also affected directly by the governments of other countries. As they have operations in multiple locations, they are affected by policies of the various host governments. In addition, they interact with customers and suppliers in multiple locations, and must abide by their regulatory requirements.

It is important to highlight that while there is indeed a more complex milieu in terms of the types of actors engaged in the globalization-era system, the degree of embeddedness between these various actors is still in flux. Comparing Figure 2 with Figure 3, the cross-border aspect of the new developing country system is still shallow compared to the developed country system. This is especially so because a number of newer players – such as

inward investors – are not fully embedded within the formerly national system. MNCs – despite treaties within the WTO requiring national treatment in most sectors – are still not accorded equal treatment in most developing countries. A variety of issues still remain outstanding, with the so-called ‘Singapore issues’ covering government procurement, agriculture, health, and services remaining unresolved. National policies are not always concordant with international accords. In other cases, national policies such as intellectual property rights protection are simply not implemented, or implemented half-heartedly, in countries as varied as India, China, and South Africa. Governments and other non-firm actors have not adapted to their new roles, and have often not fully acknowledged the new realities of regulation and the importance of providing location advantages. Essentially, institutions (both formal and informal) have failed to keep pace with the new national configuration. I discuss this further in the next section.

THE INEFFICIENCY OF SYSTEMS AS A BARRIER TO UPGRADING IN EMNCs

The discussion in the previous section about the new reality of a larger number of actors is a stylized one. Nonetheless, there is considerable variation in the degree to which actors have responded to opportunities – both potential and immediate – to embed across borders, and to exploit cross-border interdependencies.

In addition, liberalization has not always led to a growth in the domestic firm sector. The influx of foreign-owned and controlled MNCs has increased the competition levels faced by domestic firms. Crowding-out affects firms that have weaker FSAs (Beaudry & Breschi, 2003). Crowded-out domestic firms simply do not have the FSAs to compete against large foreign MNCs, which have scale economies as well as greater efficiencies that derive from being multinational. At a broader level, the failure of domestic firms in developing countries to overcome increased competition reflects the weaknesses of the system, which has not been able to respond to the challenges of liberalization because the necessary location assets did not exist, in terms of technological and absorptive capacity. This may reflect a weak non-firm sector which is unable to assist domestic actors in upgrading their assets. It may also reflect a failure to link up development and industrial policies with FDI policies. Upgrading of domestic actors through spillovers and linkages from inward FDI is not an automatic process, and requires a certain threshold level of absorptive capacity (Narula & Dunning, 2010; Morrissey, 2011). Spillovers are externalities that accrue from one firm to another, and imply a process of learning by the recipient firm because of some formal or informal association between the firms in question (Morrissey, 2011). MNC-assisted development presumes that inward investors will create linkages with local firms, but where these firms do not have the requisite skills, such linkages will be established with suppliers located abroad, with whom the MNC already has associations in its other operations. Even where linkages are indeed established, this does not imply that spillovers will occur (Narula & Driffield, 2011).

The point is that moving from pre-globalization (as in Figure 1) to a globalization era structure (as in Figure 3) does not happen automatically. Actors in any system tend to change their existing patterns of cooperation and interdependency grudgingly. This is known as ‘inertia’, and reflects the tendency of actors to replicate their previous actions, and a reluctance to implement change or modify routines. Inertia by itself is a natural phenomenon, and is neither ‘good’ nor ‘bad’. Inertia can be positive when actors develop inertia around

routines that have historically generated a positive outcome. A fundamental shift from one political and/or economic regime or policy stance can also represent a discontinuity or 'shock', which requires a modification of existing routines. Inertia is not the same thing as an inability to upgrade. At the country level, there is often a strong institutional inertia to overcome; whether the discontinuity is as fundamental as the one experienced by the former centrally planned economies during their transition, or is from an import-substituting stance to a more open, export-oriented one, as experienced by many developing countries, the difference is only one of degree (Neuber, 1993; Narula & Jormanainen, 2008).

Inertia can be a pervasive phenomenon at the level of a whole economy, because often there is a self-reinforcing interaction between industrial enterprises; the infrastructure and politics which perpetuates the use of specific technologies, production of specific products, and/or through specific processes; and specific customer-supplier associations. Institutional restructuring is not an instantaneous or costless process, and results in inefficient outcomes because actors in the system are obliged to alter their *raison d'être*. Institutions developed for, or specialized around, a particular economic system are not efficient in responding to the needs of another system. In the case of the import-substituting countries, institutional inertia was often associated with selected industries built around national champions. Institutional inertia in most cases has meant that aspects of import-substitution policies continue to shape the 'flavour' of current policies, particularly those to do with national champions and interest groups, who continue to heavily influence policy (Narula, 2002).

Actors in that system can become locked-in to specific industries and specific technologies. Therefore, it is not uncommon that the technological specialization of both firms and locations changes relatively slowly over time (Cantwell, 1989; Cantwell & Iammarino, 2003). Over-specialization of knowledge infrastructure to meet the specific needs of a specific sectors and industries can also lead to *ex post* inefficiencies. Firm-infrastructure relations can be so closely interdependent that the boundaries and functions of firms and the various components of the knowledge infrastructure are unclear, and *de facto* operate as one large unit (Grabher, 1993). Rigidities due to the inertia of institutions and the knowledge infrastructure can seriously affect the ability of an economy and its actors to adapt to new technologies, and/or the entry of new actors into the system. If inertia persists over a long period, domestic actors will not survive unless non-firm actors (typically government policy-determined organizations) or firms themselves seek to address these constraints and are able to overcome the lock-in. However, the external agencies themselves often suffer from cognitive inertia, or are constrained by politics from radically modifying the system.

The non-firm sector is important as an agent of change when major exogenous shocks occur, because it has the potential to minimize the disturbances from the environment (Johnson, 1992). By establishing standards, subsidising basic research, providing incentives to sunset industries to restructure, and improving the available human resources needed for new sectors, the non-firm sector can help overcome structural problems due to liberalization. For instance, this sector can help to retrain workers in new skills and sectors, or change the university curricula, etc. It can create incentives for the adoption of new technologies, or improve the access to these technologies by making them available more cheaply. However, government intervention is conditional on available resources. Developing country

governments and firms often do not have the resources – or the expertise – to invest in reducing the shock of exogenous changes. There is also the somewhat larger problem of an inefficient non-firm sector, and an unresponsive government (government failure being a widespread problem in developing countries). As such, the knowledge infrastructure may be unable to overcome lock-in as rapidly as firms need.

Firms also suffer from inertia, and ultimately institutional inertia (where governments do not respond) has to be addressed by firms who have an incentive to respond to environmental changes. They may respond to these challenges by replacing the inefficiencies of the state by creating internal alternatives to knowledge infrastructure. This may be through creating firm-specific training facilities (for example, Indian conglomerates Tata and Infosys have their own universities). Others overcome limitations in local capital markets by relying on intra-conglomerate loans. Limitations in IPR protection are overcome by a greater degree of vertical integration. These solutions, however, depend upon being large in terms of size, and being able to cross-subsidise, which also means generating larger than normal profits to cover these costs (which in turn, implies remaining in protected markets). Internalising functions that are traditionally location advantages (in principle available to all) also means that new entrants must resort to internalising such activity, acting as a barrier to entry and a limit to being embedded locally.

This also implies that domestic firms from developing countries may find it cheaper to move their activities abroad to access more efficient knowledge infrastructures, rather than developing their own solutions to the weaknesses of the home system. In other words, firms may choose an exit strategy, seeking to re-locate all or parts of their innovative activity to exploit a more optimal SI elsewhere.

Most countries do not have an ‘ideal’ system, with most countries’ systems being ‘incomplete’ or ‘unbalanced’ because some aspects of the systems are inefficient or simply non-existent. This is especially so in developing countries. Even where an efficient, complete, and balanced system exists, exogenous shocks are likely to create inefficiencies. Institutions are the ‘glue’ that bind the various actors together, and determine the efficacy of their interaction (or lack thereof). Formal institutions are codified and administered by state-administered organizations which are themselves formal institutions, since they are formally defined by law, and their structures are designed to create and implement new and existing formal institutions. Indeed, the political and economic spheres are rarely independent, and this is all the more so in a pre-globalization era, in developing countries that had implemented import substitution programmes, or in the former centrally planned economies. In general, the policy environment in which economic actors function has a high degree of interdependency between the economic and political spheres. Informal institutions represent routines which are essential to the implementation of formal institutions. One of the most important aspects of informal institutions is that they cannot be easily established, and once established, cannot be easily modified.

The point I am trying to make here is that you may have all the ‘building blocks’ of a ‘globalized’ economic system, but they may still not work together efficiently, because institutions do not always adjust themselves as rapidly as necessary to the new realities of the globalization. Emerging economies have moved towards a open system structure similar to

that of the developed economies, but because of structural and institutional inertia, or simply due to a resource constraint, they may not function efficiently.

Domestic firms may respond to poor domestic systems by relocating themselves (or part of their activities) to another country through FDI. Nonetheless, this option is not as straightforward as it may seem – entering a new country with the goal of accessing an innovation system in the host economy is not costless. Embeddedness takes time to achieve, again, because the knowledge of institutions takes time to acquire. Furthermore, not all location advantages are public goods, especially those associated with knowledge-intensive sectors. As I discuss in the next section, some location advantages are ‘members-only’. This has consequences for embedding foreign MNCs in developing countries (thereby affecting these countries from linkages due to inward FDI), and the abilities of emerging country MNCs to embed themselves abroad (and therefore attenuating the possibility of their home countries benefitting from reverse knowledge transfer).

THE STICKINESS OF LOCATIONS, ‘MEMBERS-ONLY’ ACCESS AND THE INTERNATIONALIZATION OF EMNCs

Earlier interpretations of the eclectic paradigm suggest that Location (L) advantages are a set of characteristics associated with a location that are in principle equally accessible and applicable to all firms that are physically or legally established in that location. L advantages are about relevant complementary assets outside the boundaries of the MNC (or other firm actor) that are location-bound (Narula & Santangelo, 2012). However, in this paper we take the view that not all L advantages are in fact freely available to all. In essence, location advantages are ‘public’ goods because they are not private goods, but not always in the sense of being ‘public goods’, because they may not be used by others without (some) detriment to their value.

The key to appreciating L characteristics is that universal accessibility can be ‘in principle’. They are ‘in principle’ available to all, but some are more public than others; this is the central point I want to make. I want to distinguish between two types of L advantages. First those that resemble the classical view of L advantages: ‘public good’ L advantages, which are available at marginal (and similar) cost to all economic actors in a given location. They remain macro and ‘generic’, and are available to all firms regardless of size, nationality, industry, or geographical unit of analysis. Some are exogenous, and are the natural assets of the location, such as population, climate, accessibility, etc. Some are independent of economic stage of development (such as the presence of natural resources), while others are stage-dependent and endogenous, in the sense that the various actors within a system contribute to their development. Examples include skilled and unskilled human capital, health care, utilities, telecoms, ports, security, efficient bureaucracy, public transport etc. Others are sociological or anthropological, such as culture, norms, religion, and political stability (Narula & Santangelo, 2012).

The second type of L advantages are quasi-public goods, whose access is a function of membership in a system or network of actors. I will call these ‘members-only’ L advantages; elsewhere I have also referred to them as collocation L advantages (Narula & Santangelo, 2012), although they are not in fact the same thing. The difference between the two types is that collocation advantages do not have to be restricted to ‘members only’.

Collocation L advantages derive from the proximity of other actors, may be externalities, and are in principle available to all collocated firms. For instance, where firms in the same industry are collocated, there is an opportunity to get appropriately skilled and experienced workers and the possibility of knowledge spillovers through mobile employees.

‘Members only’ L advantages are associated with ‘clubs’. To paraphrase the American Express marketing department: ‘membership should have its privileges’. Just as in any respectable club, the value of membership derives from the value of the goods and services that it provides members, and the exclusivity of access to these goods and services. The exclusivity implies barriers to entry, such as fees. However, not all clubs arise by creating exclusivity – it can be the exclusivity that causes clubs. When a certain set of assets is in limited supply, those with access to them do not wish to compete with others through markets for this access. Creating restrictions to new entrants and establishing quasi-internal markets for scarce resources then becomes a viable strategy.

A systems view is crucial to understanding ‘members-only’ L advantages for two reasons. First, the effect of interactions is central to understanding the actions of firms, including their choice of location. It is not just the presence of suppliers, customers, competitors, or regulators. Each on its own plays a role, but the synergetic effects are a function of the sum total of the presence of all these factors. These are economies of agglomeration, and it is this that determines the ‘stickiness of locations’ (or its absence). Spillovers tend indeed to be more intense between parties that are located close to each other in space (e.g., Jaffe & Trajtenberg, 1996; Jaffe & Trajtenberg 1998; Jaffe et al., 1993; Maurseth & Verspagen, 2002). The marginal cost of transmitting *codified* knowledge across geographic space does not depend on distance, but the marginal cost of transmitting *tacit* knowledge increases with distance (Criscuolo & Verspagen, 2008). The spatial aspect has also been evaluated in terms of the compatibility of organizational cultures and social networks that reflect the culture of the location, and these themselves are shaped by the nature of the polity, and the social and economic institutions of that location (Granovetter, 1985). The systems perspective helps us to understand these various stimuli as a ‘package’, rather than a collection of discrete components. It also helps us to link to the idea that there are certain kinds of knowledge that are only available to members with a particular location-specific absorptive capacity by virtue of their constant interaction. Firms are embedded in different and unique external local networks of suppliers, customers, competitors, institutions, authorities, and associations (Forsgren et al., 2005; Ghoshal & Bartlett, 1990; Granovetter, 1985; McEvily & Zaheer, 1999). It is well known that trust between network members lowers the costs of negotiation and resolves conflict (Zaheer et al., 1998). In particular, network membership reduces opportunistic behaviour and improves knowledge transfer, because network members have a greater awareness of the informal institutions that govern their interaction (Gulati, 1998: 304).

Second, understanding agglomerations by considering a systems view allows for the emphasis of institutions, and helps us to come to grips with the well-known but terribly imprecise concept of something that is ‘in the air’ (Marshall, 1920). Embeddedness in a location provides membership in a ‘club’ of complex relationships with suppliers, customers, and knowledge infrastructure through formal and informal institutions. These are ‘goods’ associated with the networks that are only available to those that are collocated, because they

have evolved under the same informal institutions. Thus they are quasi-public goods, which firms located there have invested in to acquire knowledge of these institutions (Narula & Santangelo, 2009).

Members-only L advantages have a lot to do with informal institutions. In particular, and sometimes most fundamental, is the ‘know-who’ (Narula 2002). Building up links with various actors (in the IB literature, this is analogous with ‘trust’ and ‘relationship capital’), is time-consuming and expensive, but once created, these links have a low marginal cost of maintenance.

For an outsider, the high costs of becoming familiar with, and integrating into, a new system may be prohibitive (Narula, 2003). These are the liabilities of outsidership. For an insider, however, such membership comes with privileges which provide opportunities for rent generation. Indeed, more recent work on informal institutions – which are notoriously difficult to quantify – points to the absence or inefficiency of institutions as a primary force inhibiting economic development (e.g., Rodrik, 1999; Rodrik et. al., 2004; Asiedu, 2006).

The concept of location is a generic one, allowing us to speak of different units of analysis, even though the assumption remains that the default unit of analysis is the country. However, even within countries, sub-national regions have different sets of L advantages (Narula & Santangelo, 2012). Supra-national regions, such as the European Union (EU), that function as a single administrative unit also need to be considered in certain cases, because they provide an additional layer of policies, regulations, and laws. An MNC may engage with all three levels of location.

When location-bound assets are in the private domain (i.e., they are internalized by specific economic actors), they are no longer L advantages but constitute firm-specific assets, since they assist rent generation/market share retention by specific actors to the exclusion of other economic actors. That the primary difference between FSAs and location advantages is a matter of internalization is an important point. It is therefore not especially surprising that FSAs can be location-bound and ‘sticky’, that is, they are most effectively utilized in specific location and firms have difficulty exploiting them in other locations.

That firms’ FSAs can be ‘sticky’ and location-bound should not come as a big surprise. Until about the 1960s, economic activity was presumed to be largely immobile, because both capital and labour were seen to be location-bound, and self-evidently there was little propensity to mobility. The field of IB has largely revolved around explaining the rapid growth of MNCs in these 50 years, and it is a recent phenomenon that scholars have begun to presume the exact opposite, i.e., that all assets and firms are largely mobile.

One of the constants – despite the structural changes in the world economy, and a move from location-bound firms to MNCs – is that it is still largely true that the competitiveness of firms is primarily shaped by the attributes of the location, and as locations have evolved in the nature of their inherent strengths and weaknesses, the kind of economic activity based there has also fluctuated. This had obvious ramifications for the nature and extent of trade, and the conditions that permitted one region or country to be more successful than others.

Nonetheless, the modern MNC has gradually decoupled the relatively straightforward relationship between the competitiveness of firms in a given location and the competitiveness of the location itself. Conventional wisdom in a pre-globalization era held that the

competitiveness of countries explained the competitiveness of firms located there, and while this is still true, it is less so than it was a few decades ago. The ‘typical’ firm in the 1950s was neither multinational nor multi-plant. It was also organizationally and geographically associated primarily with one or a few locations, and with one or a few countries. Economic studies were able to work under the realistic assumption that firms could be viewed as generic (Beugelsdijk et al., 2010). The more spatially and organizationally complex the MNC has become, the greater has become its interdependence upon multiple locations, each with varying degrees of embeddedness (Meyer et al., 2011). In the globalization era, the MNC has the potential to shape the characteristics of its location as much as it is itself shaped by its milieu, given that it is embedded in several locations. However, fully globalized and ‘transnational’ MNCs for whom the home country plays a marginal role are still the exception and not the rule: home countries and regions continue to account for the lion’s share of MNC activity. This is certainly true for emerging country MNCs.

As such, location plays a central role in understanding the nature, extent, and rate of internationalization of firms and the evolution of the ‘typical’ MNC. It also helps to underline that locations matter not in a generic sense of countries, but in the sense that locations are about the agglomeration of a variety of activities by a large number of actors who happen to be collocated.

CLOSING REMARKS: THE LIMITS OF EMNC MOBILITY AND IMPLICATIONS FOR HOME COUNTRY POLICY

The beginning of the third millennium has largely been marked by a celebration of the highlights and dubious outcomes of globalization, which is inextricably linked to a discussion of the role of capitalism. The ‘sudden’ appearance of certain emerging economies as active and significant players in the world economy is one of the recurring themes of this the current epoch. The arrival of certain emerging economies as important home and host countries for outward FDI, and their rapid growth over the last two decades, has been taken as a sign that they have adapted well to the opportunities of globalization.

This line of thought has some fundamental flaws. Globalization has wrought some fundamental changes to the structure of the emerging economies. In no small part, this is due to economic and political liberalization, but the necessary systematic transformation of these economies is still far from complete. There is a high degree of endogeneity and interaction amongst and between institutions, science and technology infrastructure, the competitiveness of industrial enterprises, and the endowments of any given economy. The sudden exposure of these economies to the vagaries of international competition has not necessarily facilitated their institutional restructuring. Liberalization in developing countries did not always take place gradually, as was the case in most developed countries. Even the success stories like Brazil, India, and China have not been able to shift easily to taking a multilateral view towards hitherto-domestic issues. Institutional inertia in most cases has meant that developing countries have been quick to see the costs of globalization (principally the erosion of economic [and political] sovereignty and the sterility of policies and attitudes associated with import substitution) as outweighing the benefits associated with it. Although by the mid-2000s, many developing countries had largely overcome institutional inertia due to the shift towards open economies, it continues to shape the ‘flavour’ of policies. National champions

and interest groups dominant in the IS era continue to hold sway; a suspicion of MNCs continues to limit access in certain sectors. This means that new inward FDI to emerging economies still struggles to embed itself in these economies, limiting the opportunities for spillovers to the domestic sector. With the arrival of a wide variety of new actors, and the growth of outward activity, the equilibrium within many countries has been lost, and they are still adjusting to a wide variety of new formal and informal institutions. This has significant implications for EMNCs, who have moved abroad in some cases as a reaction to the institutional instability at home (Khanna & Palepu, 2006; Witt & Lewin, 2007). They have also relocated in response to the limited learning opportunities in the domestic economy, given the inability of the state to provide world-class knowledge infrastructure. Where the local system does not meet the needs of firms, they can respond by exiting, so as to acquire these inputs from systems which are able to provide them (Narula, 2002).

It is true that liberalization has helped correct many inefficiencies, *inter alia*, improving important macro-economic fundamentals, and reduced the excessive role of the state in domestic industrial activity. On the other hand, it has also led to a rapid and overzealous reduction in the state's involvement in the provision of public goods and location advantages which are necessary conditions for industrial development (Katz, 2001). It is worth noting that another important feature of globalization – rapid technological change, and a growing share of knowledge-intensive activities within traditional labour intensive fields – requires new kinds of L advantages from countries that have difficulty providing the most basic infrastructure.

It is also true that there a certain group of EMNCs are internationalising from a position of strength, and engaging in market-seeking investments abroad. However, a number of these firms are only now beginning to realize that internationalization requires more than having superior products and services. Firms also need transaction-type O advantages which include the ability to organize and manage complex cross-border hierarchies (Narula, 2012). These are not easily acquired. As research on intra-firm knowledge flows has shown, moving knowledge between affiliates is a challenging task (Monteiro et al, 2008).

EMNCs (like all MNCs) hope to be able to integrate themselves into their foreign locations to exploit location-specific assets in combination with their O advantages. However, this requires recombinant 'bundling' advantages. Determining how to most efficiently integrate O and L advantages together is not an easily acquired capability (Verbeke, 2009; Narula, 2012). This brings up the challenges of reverse knowledge transfer. Firms seeking to transfer knowledge assets acquired in one location to others (and in particular to their parent firm in the home country) are faced not just with the challenges of intra-firm knowledge transfer, but also the challenge to integrate and transfer these assets to its affiliated suppliers and related firms (Rabbiosi, 2011). At a broader level, we do not know how MNCs transfer knowledge effectively between different organizational units, and more importantly, why some firms are more successful in leveraging knowledge created elsewhere. Indeed, this is a significant issue for EMNCs.

In addition, however, EMNCs need to acquire access to specific L advantages which may not be 'public good' type L advantages, but rather 'members-only' L advantages. Becoming integrated within a specific national or regional system is a time-consuming

process, because becoming an insider is not a straightforward process. Such knowledge is hard to acquire or exchange through markets.

Although I have not dwelled on the matter, this paper provides a precursor to explain the location-boundedness of the FSAs of firms. It is now well recognized that not all FSAs are easily portable, as Rugman and Verbeke (2001) highlighted, which naturally raises the question of subsidiary-specific advantages that are not necessarily available to the MNC at large. These require us to revisit the nature of FSAs.

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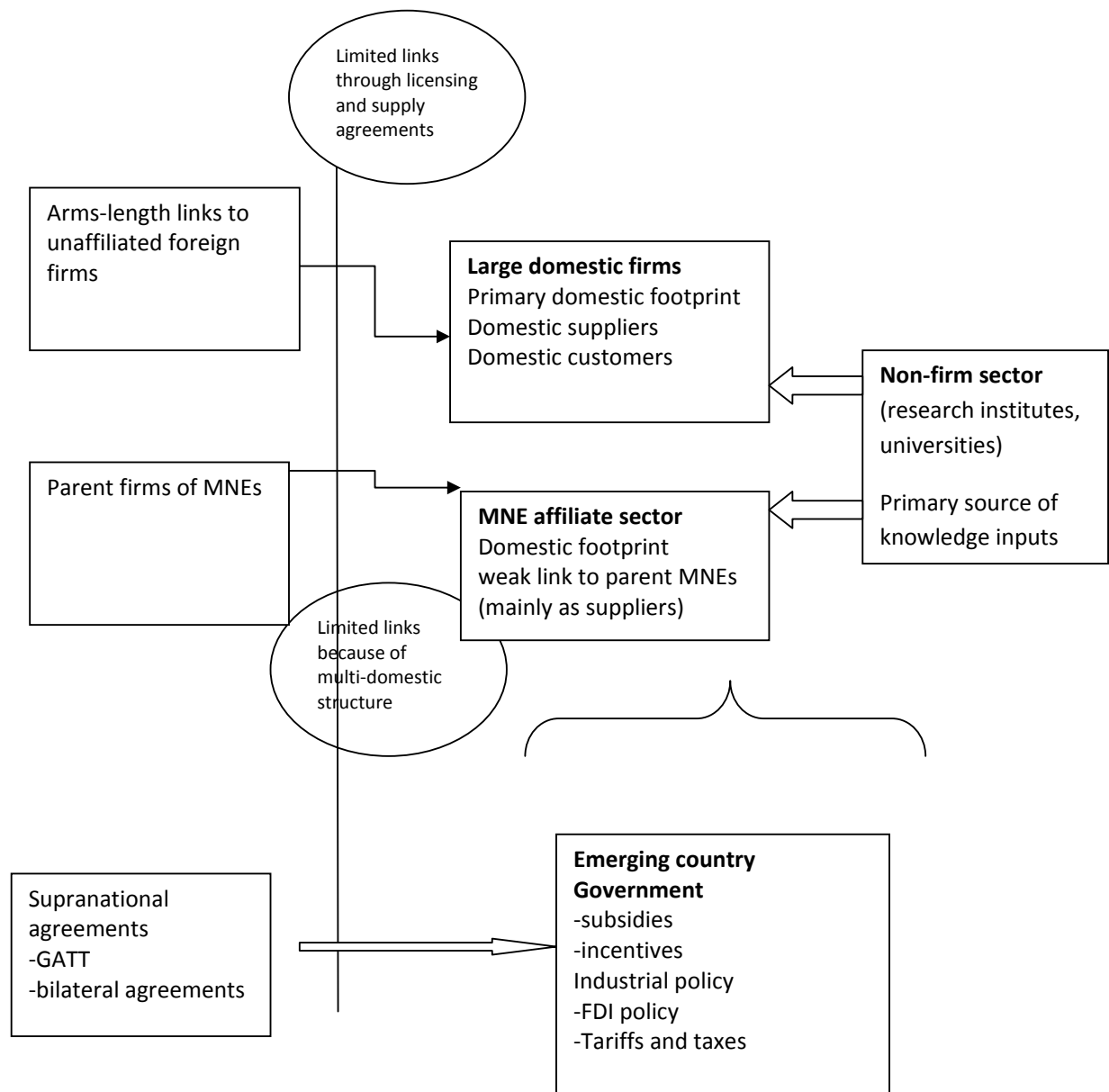


Figure 1: Pre-globalization national systems

Source: author

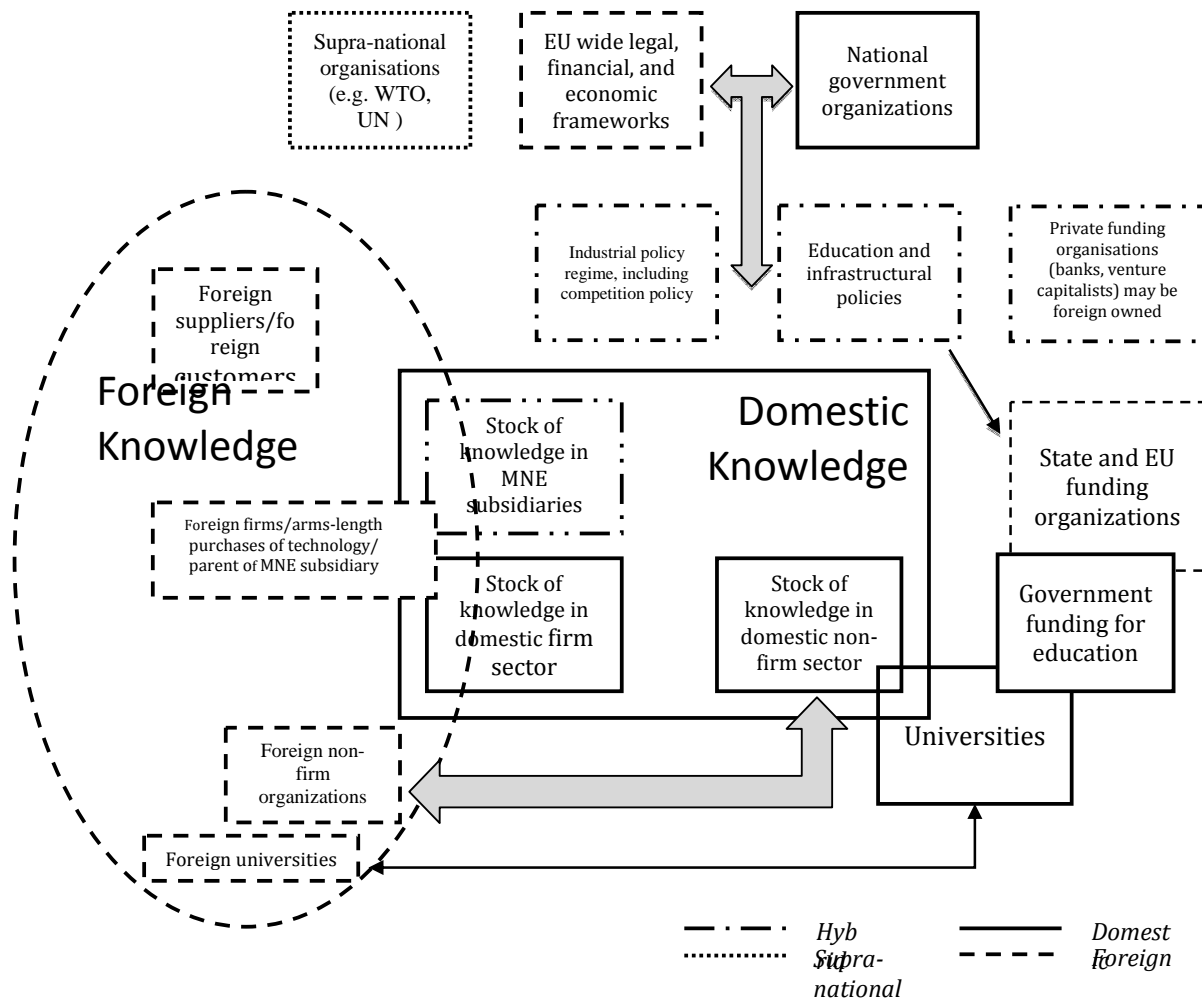
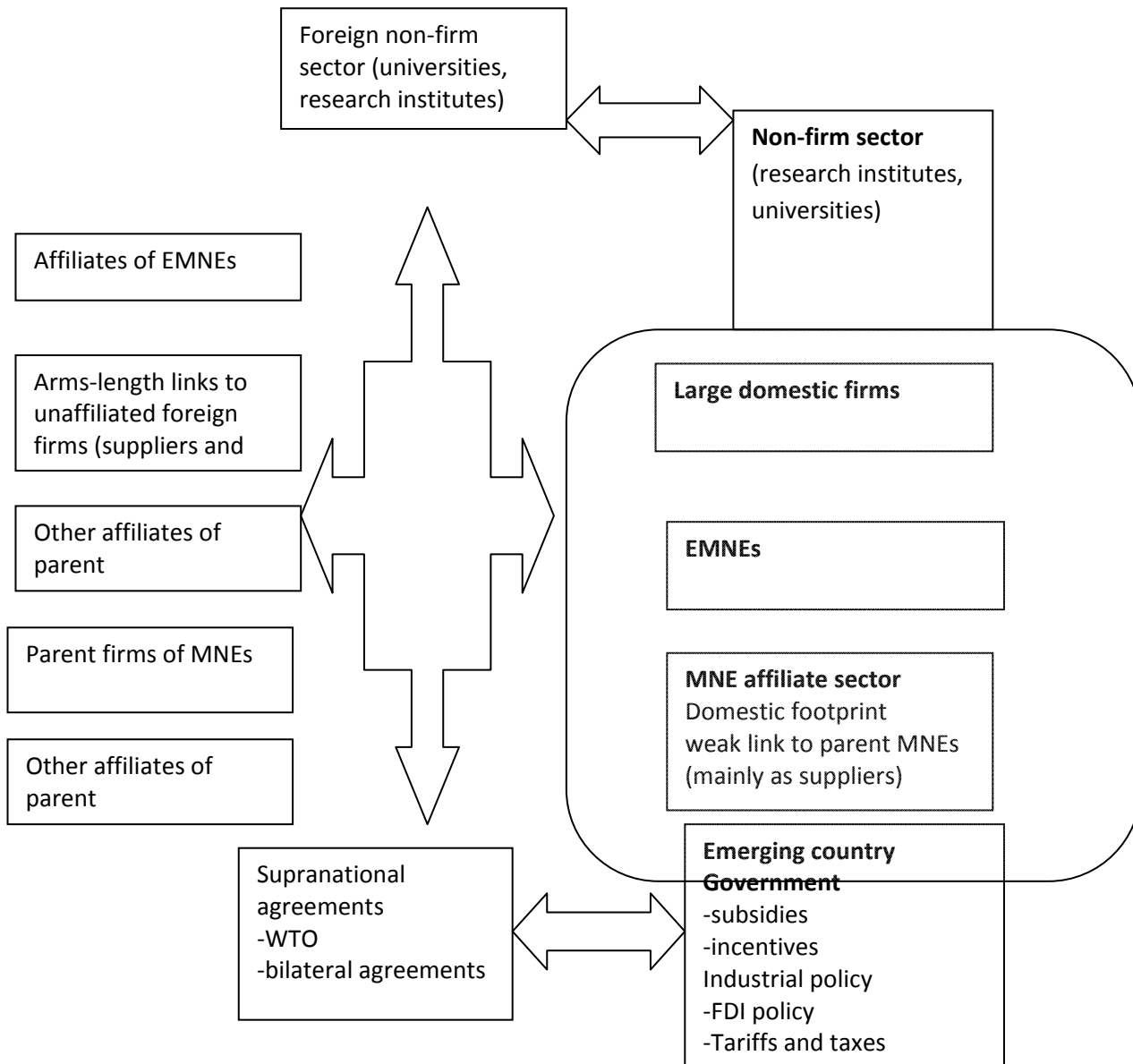


Figure 2: Interrelationships within the system of a typical EU country.

Figure 3 Globalization-era system

Source: author



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